

**Caldwell UNC Health Care Comments Regarding Blue Ridge Surgery Center
Cost Overrun CON Application, Project ID No. E-11987-20**

Overview

In March 2019, Blue Ridge Surgery Center obtained CON approval for Project ID # E-11298-17 to allow for the development of an ambulatory surgery center (ASC) by separately licensing four operating rooms and two GI procedure rooms within the existing CHS Blue Ridge Valdese Hospital structure. Because the project capital cost is now expected to exceed 115 percent of the amount that was approved for Project ID # E-11298-17, Blue Ridge HealthCare Hospitals, Inc. and Blue Ridge HealthCare Surgery Center, LLC (collectively CHS Blue Ridge) recently submitted a Cost Overrun CON application, Project ID No. E-11987-20.

In the 2020 Cost Overrun CON application, the applicants are required to demonstrate that the project application conforms to the Certificate of Need Review Criteria in accordance with the CON law. However, CHS Blue Ridge still does not provide comprehensive total costs for the more extensive and complex construction that will be required to meet current building codes. Additionally, the current proposal fails to demonstrate financial feasibility due to the absence of financial proforma and the omission of the lease for the more costly project. The application should not be approved because it is incomplete and fails to conform to the CON review criteria.

According to CHS Blue Ridge, the Cost Overrun application does not need to be fully assessed by the CON Review Criteria because the Agency accepted the representations for Project ID No. E-11298-17. This position is incorrect because key facts in the previous CON application were incorrect. Some examples of the false representations from the previous CHS Blue Ridge proposal that carry over to the Cost Overrun project application include:

- Operational and financial projections are reliable and based on reasonable assumptions
- The project requires only minor renovations
- No start-up costs are required
- The lease is based on reasonable assumptions

CHS Blue Ridge chose not to submit any updated operational and financial projections to demonstrate that the current application conforms to the CON Review Criteria. The cost overrun is due to substantial increases in construction costs and additional architect fees, plus additional construction related costs. Furthermore, the current capital cost budget is unreliable because the DHSR Construction Section has not received complete information for the basic architectural plans nor have the plumbing, electrical and mechanical plans been reviewed. No start-up costs are projected even though the construction within the existing surgery suite will last many months. The Cost Overrun application fails to provide an updated lease agreement that defines the square footage area, building systems requirements and annual costs for the project. Practically speaking, construction on this project has not yet begun, and thus the Agency should not feel compelled to approve a cost overrun application as a matter of course. This project stands in stark contrast to many cost overrun applications, where a project is partially completed but additional capital is required to complete the project. The Agency should deny this cost overrun application. Additional reasons why the application should be found nonconforming to the CON review criteria are outlined in the following sections that are specific to the CON Review Criteria.

Criterion 3

The CHS Blue Ridge Cost Overrun application does not conform to Criterion 3 because the utilization projections are unreasonable and based on outdated assumptions. The Cost Overrun application defaults to the invalid projections from CON # E-11298-17 instead of providing updated projections based on actual utilization data for the interim and current years. The previous application made specific representations regarding how and when physician recruitment was expected to boost ASC referrals beginning in Calendar Year 2019. The Cost Overrun application includes no physician recruitment update or utilization projections for the ASC that is now expected to become operational in 2022. The representation that the operational projections for Cost Overrun CON application Project ID No. E-11987-20 would be the same as CON Project ID # E-11298-17 is false because the opportunity for CHS Blue Ridge to recapture lost surgical referrals from orthopedic surgeons and otolaryngologists has expired.

Utilization projections included in CON # E-11298-17 application are not reasonable because dramatic changes have occurred in the real world that negatively affect the utilization trends:

- The 2020 SMFP shows that the surplus of ORs in Burke County has increased as compared to the surplus in 2017 SMFP.
- Endoscopy utilization at CHS Blue Ridge has dramatically declined as compared to the utilization portrayed in 2017.
- While the Blue Ridge ASC project is delayed, physicians and patients have greater choices to utilize freestanding ASCs.
- In April 2020, CHS Blue Ridge began postponing hospital-based surgeries and procedures due to COVID 19 which will diminish utilization and growth prospects.

The projected surplus of operating rooms in Burke County has increased subsequent to the submittal of CON # E-11298-17. In the 2017 State Medical Facilities Plan (SMFP), the surplus of 4.13 operating rooms was reported as compared to the 2020 SMFP having a surplus of 4.23 operating rooms. Also, endoscopy utilization at CHS Blue Ridge in 2019 declined by 32.5 percent since 2016. Consequently, the utilization projections that were included in CON # E-11298-17 are overstated and unreliable.

Current utilization data for the services are relevant to the Cost Overrun project application because the increase in the project capital cost could be offset by decreasing the scope and square footage of the project with fewer operating rooms and/or GI endoscopy procedure rooms. In spite of the surplus of operating rooms in Burke County and the higher cost for construction, the Cost Overrun application does not provide updated utilization data and projections to demonstrate the need for the project. Nor does it discuss the option of decreasing the project scope and square footage. The CON law is a cost containment mechanism, and with the Cost Overrun Application CHS Blue Ridge is instead driving up costs with the increased scope and construction costs for this project.

Increased competition is the reality that is now facing CHS Blue Ridge. Physicians and patients are free to choose to use Viewmont Surgery Center, Carolina Digestive Care, Graystone Surgery Center or the newly-developed Prime Surgical Suites in Granite Falls.

The following chart shows the licensed and accredited ambulatory surgical facilities that are in close proximity to the proposed CHS Blue Ridge Valdese project.

	Multi-specialty	Multi-specialty	GI Endoscopy	Ophthalmology	Ophthalmology
	Viewmont Surgery Center 3 ORs 50 13th Avenue N. E.; Hickory, NC 28601	Prime Surgical Suites 3 ORs 180 River Bend Drive; Granite Falls, NC 28630	Carolina Digestive Care 2 GI PRs 107 B Mica Ave. Morganton, NC 28655	Graystone Surgical Center 3 ORs 2424 Century Pl SE, Hickory, NC 28602	Morganton Eye Surgery Center 2 ORs 335 E Parker Rd; Morganton, NC 28655
CHS Blue Ridge ASC, Valdese NC (Multi-specialty) 4 ORs and GI Procedure Rooms 720 Malcolm Blvd. Valdese, NC 28690	16.1 miles	13.1 miles	9.4 miles	17.1 miles	9.3 miles

These existing facilities in Hickory, Granite Falls and Morganton provide physicians and patients with a broad range of options in freestanding ASCs that are licensed and accredited. These ASCs can also add procedure rooms without having to obtain CON approval. Unlike the proposed Blue Ridge Surgery Center, these existing ASCs are physically, operationally and financially separate from any hospital facilities. Patients who have become accustomed to the safety and convenience of modern freestanding ASCs will be reluctant to utilize the proposed Blue Ridge ASC that will be retrofitted into the outdated Valdese Hospital facility. Physicians who have the opportunity to invest in an ASC will be highly skeptical of the Blue Ridge ASC that must lease all of its physical assets from a hospital that also holds majority ownership.

The proposed Blue Ridge project will remain on the same hospital campus of CHS Blue Ridge Valdese Hospital where infectious patients are likely to seek care and be treated. Consequently, prospective patients and surgeons could still have the negative perception that CHS Blue Ridge Surgery Center is hospital-based as opposed to a genuine freestanding ASC. In early 2020, hospitals and ASCs throughout the country have had to respond to the COVID-19 pandemic by postponing elective surgery. The CHS Blue Ridge Cost Overrun application briefly acknowledges the COVID-19 pandemic but provides no interim year or current year utilization projections. The 2021 North

Carolina License Renewal Applications for hospitals and ambulatory surgery centers will evaluate to what extent the pandemic reduced outpatient surgery utilization. As with all CON applications, the Agency should analyze the available utilization data including the 2021 SMFP and the most recent License Renewal application to determine the reasonableness of the representations in the CHS Blue Ridge Cost Overrun application.

Criterion 5

Comments submitted previously regarding the 2017 Blue Ridge Surgery CON Project # E-11298-17 stated that the capital cost estimate, based on a plan to simply install firewalls, was inadequate to address the facility requirements for a separately licensed ASC. Now the Cost Overrun application Project ID No. E-11987-20 confirms that the previous proposal was poorly conceived and lacked an adequate capital budget. Earlier this year, the architects for Project # E-11298-17 were dismissed. But even with the new architectural firm, the Cost Overrun application is defective because it:

- Fails to provide adequate assumptions for the project capital cost that include any description of the scope of work for plumbing, mechanical and electrical systems even though these will be integral to the review by DHSR Construction.
- Neglects to respond to the letter from the DHSR Construction Section dated October 5, 2020 that describes the information that is still required for the architectural plans.
- Omits the square footage of the project and an explanation of how the ASC portion of the facility will be defined.
- Excludes any updated lease agreement that describes the terms and operating costs for the ASC facility that connects to the current capital cost estimate.

It should be a huge red flag to the CON Section when a Cost Overrun application is submitted with a 50 percent increase in capital cost, no updated utilization projections and no new financial pro forma that is specific to this project. In the past the Agency has generally advised CON applicants to provide more than just the minimum information and to adequately explain the methodologies and assumptions in its application. Also, the Agency has conducted reviews of numerous Cost Overrun and Change of Scope applications that did include updated utilization projections and financial pro forma.

The previous CON application CON Project # E-11298-17 claimed that no start-up costs or working capital would be required as the Valdese Hospital surgery suite could provide surgical services until the facility was converted to an ASC with minimal renovations. The application was found conforming with Criterion 5 in reliance on these representations. Now that CHS Blue Ridge officials appear to acknowledge that the project is more complex and will require construction over several months' time, the application still contends that no start-up or working capital is required for the Cost Overrun. If there is some additional requirement for working capital or start up, it appears that CHS Blue Ridge will provide the funds. But what is omitted from the application is an explanation as to how this additional cost will be reflected in the ASC financial pro forma. It is also impossible to know how the original application would have fared under Criterion 5 if all cost information had been disclosed to the Agency at the outset.

Financial projections are unreasonable due to outdated volume projections and the fact that future operating costs for the ASC will be substantially higher due to the passage of time causing inflation and salary increases. Furthermore, the ASC lease cost has not been updated or included in the 2020 Cost Overrun application to account for the increase in the capital cost or the working capital.

Criterion 12

CHS Blue Ridge previously obtained CON approval Project # E-11298-17 with a determination that CON Review Criterion 12 was not applicable based on the applicant's incorrect claim that its proposed project did not involve construction. Now that the applicants acknowledge that the ASC project will require construction the previous architects that were involved in Project # E-11298-17 are no longer engaged by CHS Blue Ridge. A new architectural firm, Wright McGraw Beyer Architects, has been hired and has conducted preliminary discussions and meetings with the DHSR Construction Section regarding the scope and complexity of the ASC construction project

Now, in the current application, CHS Blue Ridge seeks approval for a cost overrun due to increases in construction costs and additional architect fees, plus additional construction related costs including asbestos abatement, contingencies and the DHSR Construction Section plan review fees. Thus, Criterion 12 should be applicable to the Cost Overrun application Project ID No. E-11987-20 based on

the extensive documentation of meetings and discussions that involved the DHSR Construction Section.

According to the correspondence included in Exhibit C.10-2, the ASC project will require new construction as discussed in the minutes of the August 17, 2020 meeting with representatives of CHS Blue Ridge, DHSR and Wright McGraw Beyer Architects. Furthermore, the proposed ASC will no longer use an existing healthcare classification and will be required to meet all new healthcare requirements and the 2018 Outpatient Facility FGI Guidelines. As follow up to the meeting, Jeff Harms, Acting Chief of the DHSR Construction Section sent an email to CHS Blue Ridge, DHSR and Wright McGraw Beyer Architects at 8:00 pm on August 17, 2020 stating that CHS Blue Ridge will be required to indicate what building systems and services are to be shared by written agreement. This email also documents the requirement for remote fire alarm and generator annunciator panels to be installed in the ASC project area. However, Exhibit C.10-2 provides no response letter from CHS Blue Ridge or the architects regarding the fire alarm requirements and the terms of the lease agreement that includes what building systems are to be shared.

Also included in Exhibit C.10-2 is a letter dated October 10, 2020 from Larry Beals, Architect with DHSR Construction Section, to Deanne Avery, Director Capital Projects regarding the Blue Ridge Surgery Center. The letter states that the architectural portions of the ASC project drawings are approved provided that the DHSR Construction Section receive satisfactory written responses to the review comments. This letter was copied to Wright McGraw Beyer Architects and Burke County Inspections and provides ten specific comments regarding the architectural plans for the ASC project. These include requests for verification of building code compliance including fire rated partitions and signage as well as confirmation of door widths and clearance requirements in the surgical suite. In addition, the letter states that a review of the plumbing, mechanical and electrical drawing will follow. Exhibit C.10-2 provides no response from CHS Blue Ridge or the architects regarding these ten comments.

Of additional concern, Exhibit C.10-2 includes the Project Capital Cost Form from Wright, McGraw, Beyer Architects that is signed by John M Beyer and dated October 10, 2020. This document certifies that the projected capital cost is \$2,170,740.

Projected Capital Cost Form

Building Purchase Price	
Purchase Price of Land	
Closing Costs	
Site Preparation	
Construction/Renovation Contract(s)	\$1,578,574
Landscaping	
Architect / Engineering Fees	\$124,600
Medical Equipment	
Non-Medical Equipment	
Furniture	
Consultant Fees (specify)	
Financing Costs	
Interest during Construction	
Other (specify) Contingency, Permitting, IT, Misc.	\$467,556
Total Capital Cost	\$2,170,740

The projected CON capital cost is unreliable because it lacks adequate assumptions and explanations:

1. There is no documentation from CHS Blue Ridge that the proposed project is “within a fully sprinklered building of Type II-B construction” that is a requirement according to DHSR Construction.
2. The square footage for the ASC project is omitted even though there are specific requirements to define the area of ASC occupancy for licensure and certification.
3. Construction costs estimates for electrical, mechanical and plumbing systems are unreliable because the DHSR Construction has not reviewed the scope of work or plans.

The Cost Overrun application fails to adequately explain how the cost, design and means of construction represent the most reasonable alternative for the proposed renovations. Thus, it is nonconforming to Criterion 12. The previous CON application for Project # E-11298-17 involves a much lower capital cost and financial pro forma that only extends through 2021. The applicants fail to adequately explain why the proposal will not unduly increase the costs to the applicant of providing the proposed services or the costs and charges to the public for the proposed services to begin in 2022.

The omission of the proposed lease agreement combined with the absence of updated financial proforma makes it impossible for the Agency to analyze costs and charges for the Cost Overrun project.

For all of these reasons, the Cost Overrun CON application Project ID No. E-11987-20 should be denied.